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Corporations - Liquidation Upon Deadlock in Closely-Held Corporation - Interpretion of Wisconsin Statute, Strong v. Fromm Laboratories,

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CORPORATIONS — LIQUIDATION UPON DEADLOCK IN CLOSELY-HELD CORPORATION — INTERPRETATION OF WISCONSIN STATUTE — Plaintiff, as trustee of an estate, held fifty percent of the shares of a going corporation. An election to fill all four positions on the corporation's board of directors was held. Since a by-law required that directors be shareholders, plaintiff was the only member of his own faction for whom he could vote. The opposing faction, holding the remaining fifty percent of the shares, had four eligible candidates. Votes for each of the four were cast, with one receiving one vote less than the other three. Plaintiff voted all of his shares

for himself and also cast a vote of all his shares "against any other candidates for director." The chairman ruled this negative vote a nullity and found that plaintiff and three members of the opposing faction were elected. Plaintiff, claiming that a deadlock existed, brought an action to liquidate the corporation. The trial court upheld the chairman's ruling, and found that there was no deadlock. On appeal, *held,* reversed. Plaintiff's negative vote was not a nullity, and, therefore, a voting deadlock did exist which perpetuated a split in the board of directors. A receiver should be appointed and liquidation carried through even though there was no showing of irreparable injury to the corporation, unless the parties arrange a stock transfer within a stipulated time. *Strong v. Fromm Laboratories,* (Wis. 1956) 77 N.W. (2d) 389.

The court's action in ordering liquidation was based on a 1951 Wisconsin statute, which authorizes a court to liquidate a going concern because of a voting deadlock, and does not require that a plaintiff show as a result of the deadlock irreparable injury to the corporation or, alternatively, mismanagement of some kind.[1] The trial court in the principal case had expressly found that liquidation would be detrimental to both parties, but the appellate court held that under the statute it is no longer the province of the trial court to consider this factor. Upon finding that the statutory requirements have been met, the court must decree liquidation. The court pointed out that a split board of directors cannot manage a corporation in the manner required by the statutes of the state.

It has been held in cases involving a voting deadlock that the equity court had power to grant a dissolution where such a measure was the only adequate relief available.[2] There has been a divergence of judicial reaction to statutes which provide for, or at least arguably allow, dissolution on mere deadlock.[3] The New York courts require a showing that such a decree would be beneficial to the stockholders.[4] At least one writer has

1 Wis. Stat. (1955) §180.771, "(1) Circuit courts have power to liquidate . . . a corporation: (a) . . . when it is established: . . . (4) that the shareholders are deadlocked in voting power, and have failed, for a period which includes at least 2 consecutive annual meeting dates, to elect successors to directors. . . ."

2 E.g., the Michigan court has held that where the dissension is so serious that under the circumstances it will inevitably defeat the purpose for which the corporation was created, equity could decree a dissolution. The court noted that such a circumstance was particularly likely to occur in the closed corporation, which it compared to the partnership. Flemming v. Heffner and Flemming, 263 Mich. 561, 248 N.W. 900 (1933). See cases collected in 13 A.L.R. (2d) 1260 (1950).

3 The Pennsylvania statute expressly requires a showing of irreparable injury, suffered or threatened, before dissolution of a deadlocked corporation is allowed. Pa. Stat. Ann. (Purdon, 1938) tit. 15, §2852–1107. Cf. Minn. Stat. (1953) §301.49; Mo. Rev. Stat. (1949) §351.485. See also Cal. Corp. Code Ann. (Deering, 1953) §4651; Fla. Stat. (1955) §608.28; Ill. Rev. Stat. (1955) c. 32, §157.86; Ky. Rev. Stat. (1956) §271.570; La. Rev. Stat. (1950) §12:55-56; Mass. Gen. Laws (1932) c. 155, §50; N.J. Stat. Ann. (Supp. 1956) §14:13-15; Ohio Rev. Code (Baldwin, Supp. 1956) §1701.91; Wash. Rev. Code §23.44.030. See generally CORPORATION MANUAL, 1957 ed., Tit. VIII, §48.

4 22 N.Y. Consol. Laws (McKinney, 1943; Supp. 1956) §§101, 103, 117. The New York statute is ambiguous. After stating that benefit to stockholders is one of three alternative

indicated that the New York court's reluctance to dissolve is in proportion to the company's prosperity, and that some additional factor (such as mismanagement) must be present before a dissolution decree will be rendered.[5] In other jurisdictions the requirement of actual or threatened insolvency is not deemed vital to the decree.[6] At first glance, a remedy as drastic as dissolving a going concern seems to be a cure that kills the patient. A close inspection of the situation where such a remedy is usually applied, i.e., in the closely-held corporation, suggests, however, that it is entirely in the public interest and does not give shareholders greater protection than they deserve. As a practical matter, it is in the closed corporation that deadlock is likely to occur. Since each shareholder in such a corporation is similar to a "partner" holding some fractional interest in the business, blocs of precisely one-half of the voting power can easily form, and the remedy of dissolution, which is available to partners who have reached an impasse, is quite logically applied to the closely-held corporation.[7]

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grounds for dissolution (with insolvency and deadlock being the others) a later section says the court may dissolve where it will be beneficial to stockholders. See Matter of Cantelmo, 275 App. Div. 231, 88 N.Y.S. (2d) 604 (1949).

[5] 50 COL. L. REV. 100 (1950).

[6] New Jersey, for one, has dissolved prosperous companies. Petition of Collins-Doan Co., 3 N.J. 382, 70 A. (2d) 159 (1949). Language in the decision indicates, however, that the court could not conceive of a situation where deadlock would not be harmful to shareholders in the long run.

[7] See Israels, "The Sacred Cow of Corporate Existence: Problems of Deadlock and Dissolution," 19 UNIV. CHI. L. REV. 778 (1952). The right of delectus personae preserved to partners supports by analogy dissolution on deadlock of a closely-held corporation where similar personal relations often exist. See the Michigan decision cited in note 2 supra.